An Intro to Wealth Taxes and Their Effects on the Economy

Senate Finance Committee

Joyce Manchester

January 30, 2024

DM #374080, v.2

Outline of talk

- What is a wealth tax or surcharge?
    - Why consider a wealth tax?
    - How does wealth inequality look for the United States?
- How do wealth taxes affect the economy?
    - What can be done to mitigate any negative effects?

What is a wealth tax, and how might it affect the economy?

Wealth, or net worth, is the value of assets less the value of debt owed

What is a wealth tax?

A wealth tax is usually defined as **an annual tax levied on the net worth, or total assets net of all debts, of an individual or household above an exemption threshold**.

Net worth is made up of

- financial assets such as bank accounts, bonds, stocks, and mutual funds, as well as
- non-financial assets including tangible assets such as real estate, equipment, and family heirlooms as well as intangible assets such as intellectual property—patents or goodwill

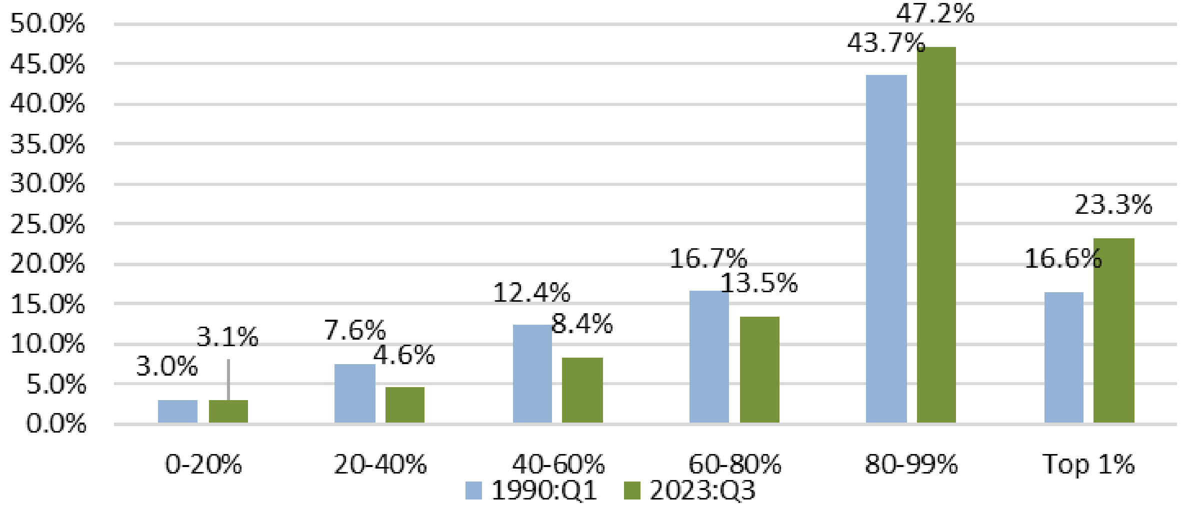
Why consider a wealth tax?

- Advocates of a wealth tax argue that it would
  - raise revenues in an effective and progressive way,
  - address wealth and income inequality,
  - affect only a very small fraction of U.S. households, and
  - likely have only a small effect on efficiency.
- Critics counter that a wealth tax would
  - negatively affect efficiency and innovation,
  - be difficult to enforce and lead to tax evasion,
  - likely fail just as it did in many European countries, and
  - possibly be unconstitutional.
    - The Constitution says direct taxes must be apportioned by state population
    - The 16th Amendment says an *income tax* does not have to follow the direct tax rule

Wealth Inequality in the United States

- In the third quarter of 2023:
  - 70.5 percent of the total wealth in the United States was owned by households in the top 20 percent of the income distribution
  - Households in the lowest 40 percent of the income distribution owned 7.7 percent of the total wealth

Figure 1. Wealth by income percentile group, United States, 1990 and 2023



Source: Federal Reserve Board, Survey of Consumer Finances and Financial Accounts of the United States.

Why consider a wealth tax, continued

Economists generally agree that the tax system is a useful vehicle for addressing the nation's income and wealth inequality, but they disagree on an optimal approach.

- A 2018 OECD report concludes "from both an <u>efficiency</u> and <u>equity</u> perspective, there are limited arguments for having a net wealth tax in addition to broad-based personal capital income taxes and well-designed inheritance and gift taxes."
  - 12 European countries had net wealth taxes in 1990, but only three European countries still levy recurrent taxes on individuals' net wealth: Norway, Spain, and Switzerland
- Efficiency: resources are allocated in a way that maximizes the production of goods and services; an ideal tax system does not distort that allocation
- Equity: taxes paid are a greater share of income for those with greater ability to pay

Emmanuel Saez and Gabriel Zucman respond to critics

- Potential reduction in the capital stock or a decrease in innovation
  - A wealth tax with a $50 million threshold would apply to only about 10 percent of total household wealth in the United States
  - Increased savings from the government and the rest of the population as the result of decreased inequality could potentially offset any reduction in the capital stock
  - Most innovation is produced by young, not wealthy individuals (who tend to be older); the young are not likely to be affected by a high-exemption wealth tax
- Failure of European wealth taxes (12 countries had them in 1990)
  - A high exemption threshold can avoid some of the problems with European wealth taxes, where the tax was levied on households with little cash but substantial illiquid wealth
  - Elizabeth Warren's proposal sets the threshold at $50 million
- Tax evasion
  - The U.S. is better positioned than Europe to prevent offshore evasion
  - Third parties could report wealth balances to the IRS to reduce reliance on self-reporting
    - S & Z expect 15% evasion rate even with strong enforcement

Wealth taxes in Europe

Norway levies a net wealth tax of 0.95 percent on individuals' wealth exceeding NOK 1.7 million (US $190,000), with 0.7 percent going to municipalities and 0.25 percent to the central government. For net wealth exceeding NOK 20 million ($2.3 million), the tax rate is 1.1 percent. Norway's net wealth tax dates to 1892.

Spain's net wealth tax is a progressive tax ranging from 0.2 percent to 3.75 percent on wealth above €700,000 ($761,000; lower in some regions), with rates varying substantially across Spain's autonomous regions (Madrid offers 100 percent relief). Spanish residents are subject to the tax on a worldwide basis while nonresidents pay the tax only on assets located in Spain.

Switzerland levies its net wealth tax at the cantonal level and covers worldwide assets (except real estate and permanent establishments located abroad). The tax rates and allowances vary significantly across cantons. The Swiss net wealth tax was first implemented in 1840.

https://taxfoundation.org/data/all/eu/net-wealth-tax-europe-2022/

Wealth tax proposals

- The California wealth tax proposal would impose a 1% tax on the net worth of residents with more than $50 million in assets, with a 1.5% bracket for those with more than $1 billion.
  - The current top income tax rate, levied on millionaires, is 13.3%.
- Vermont H.287 would include half of unrealized capital gains for income tax purposes on tax returns with more than $10 million in net worth, after allowing for $1 million in exemptions for real estate, interests in business entities, property held in trust, and personal and intellectual property
  - Most retirement accounts are fully exempted
  - Total taxable gains cannot exceed 10 percent of the taxpayer’s net worth greater than $10 million
- The Fair Share for Vermont proposal

Resources

- Federal Reserve Board of Governors, Z.1 Financial Accounts of the United States, December 7, 2023.
  - https://www.federalreserve.gov/releases/z1/20231207/z1.pdf
- Federal Reserve Board of Governors, 2022 Survey of Consumer Finances, released September 2023.
  - https://www.federalreserve.gov/publications/files/scf23.pdf
- Vermont Department of Taxes, Data and Statistics on the Income Tax, 2022 Tax Year
  - https://tax.vermont.gov/data-and-statistics/income-tax

Appendix – Additional Information

2022 Vermont Personal Income Tax Returns by AGI Percentile, Vermont Residents					
Federal AGI Percentile	Returns	Exempt	AGI Start for Percentile	Vermont AGI	Net Vermont Tax
Bottom 10%	32,812	32,331	NA	-49,111,264	-2,154,745
10% - 20%	32,813	36,282	7,214	379,292,524	-6,050,183
20% - 30%	32,809	45,287	16,602	720,183,146	-2,959,266
30% - 40%	32,809	48,187	28,284	1,084,598,357	10,064,483
40% - 50%	32,810	48,748	38,920	1,422,357,145	23,640,980
50% - 60%	32,810	51,662	49,615	1,806,174,757	37,982,308
60% - 70%	32,810	58,951	62,965	2,315,182,159	59,982,923
70% - 80%	32,809	70,432	81,920	3,060,502,549	86,054,505
80% - 90%	32,809	80,746	109,942	4,219,918,466	147,347,686
90% - 95%	16,405	41,988	159,290	2,969,985,566	129,425,853
95% - 99%	13,124	34,161	223,506	3,964,861,458	217,534,828
Top 1%	3,281	8,625	520,544	4,230,542,140	294,584,203
Totals	328,101	557,400	NA	26,124,487,004	995,453,575
Source: Vermont Department of Taxes, 2022 Income Tax Statistics					

Table 2a. Distribution of income and net worth at selected percentiles in 2022

	U.S. SCF	Tax Policy Center	VT Dept of Taxes	VT to U.S.
Percentile of income	Usual income	U.S. AGI	AGI	AGI Ratio
20	34,600	15,000	16,602	111%
40	59,500	37,500	38,920	104%
50	73,400	NA	49,615	NA
60	91,900	65,300	62,965	96%
80	153,100	135,600	109,942	81%
90	245,400	197,600	159,290	81%
95	??	289,400	223,506	77%
99	??	773,900	520,544	67%
99.9	??	4,061,800	??	NA
Percentile of net worth	Net worth			
25	27,100	NA	NA	NA
50	192,900	NA	NA	NA
75	658,900	NA	NA	NA
90	1,938,000	NA	NA	NA

Source: Federal Reserve Board, Changes in U.S. Family Finances from 2019 to 2022, Oct 2023. https://www.federalreserve.gov/publications/files/scf23.pdf; Vermont Department of Taxes; Tax Policy Center. https://www.taxpolicycenter.org/model-estimates/income-breaks-distribution-tables-april-2023/t23-0051-income-breaks-2023-tax-model